

FCC MAIL SECTION

FCC 94-269

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of )  
 )  
TELEPHONE COMPANY- )  
CABLE TELEVISION )  
Cross-Ownership Rules, )  
Sections 63.54-63.58 )  
 )  
and )  
 )  
Amendments of Parts 32, 36, )  
61, 64, and 69 of the )  
Commission's Rules to )  
Establish and Implement )  
Regulatory Procedures for )  
Video Dialtone Service )

DISPATCHED BY  
CC Docket No. 87-266

RM-8221

**MEMORANDUM OPINION AND ORDER  
ON RECONSIDERATION AND  
THIRD FURTHER NOTICE OF PROPOSED RULEMAKING**

Adopted: October 20, 1994

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Comment Date: December 16, 1994

Reply Comment Date: January 17, 1995

By the Commission: Commissioners Quello, Barrett, Ness, and Chong  
issuing separate statements.

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**I. INTRODUCTION**

1. In 1991 and 1992, the Commission adopted policies and rules to permit an expanded role by local exchange carriers (LECs) in the provision of video services in their telephone service

areas.<sup>1</sup> Prior to these orders, telephone companies were restricted by Commission rules from exceeding the carrier-user relationship with video programmers. Thus, telephone companies were generally limited in their service areas to providing "channel service," a common carrier delivery service linking a cable operator's headend to subscriber premises.<sup>2</sup> In its 1991 and 1992 orders, the Commission established a regulatory framework for telephone companies to deliver video programming on a common carrier basis, as well as provide various additional unregulated services, consistent with the cross-ownership restrictions imposed by the Cable Communications Policy Act of 1984 (1984 Cable Act).<sup>3</sup> This regulatory framework is called "video dialtone." In this Order, we consider petitions for reconsideration of our 1992 Second Report and Order, as well as a joint petition for rulemaking filed by the Consumer Federation of America (CFA) and National Cable Television Association (NCTA) (Joint Petition), seeking video dialtone-specific cross-subsidy rules.

2. As discussed more fully below, we take various actions here to strengthen our video dialtone policies. Among the more significant actions, we first reaffirm the basic video dialtone regulatory construct adopted in the Second Report and Order. LECs offering video dialtone service must make available a common carrier platform that provides sufficient capacity to serve multiple video programmers, and may not allocate all or substantially all analog capacity to a single "anchor programmer." Second, we clarify and modify our video dialtone policy to help ensure that telephone ratepayers do not have to bear the costs of video dialtone. These measures should also protect cable operators from potential anticompetitive actions by LECs, stemming from LEC incentives and opportunities to price video dialtone service

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1 See Telephone Company-Cable Television Cross-Ownership Rules, Section 63.54-63.58, Further Notice of Proposed Rulemaking, First Report and Order and Second Further Notice of Inquiry, 7 FCC Rcd 300 (1991) (First Report and Order), recon., 7 FCC Rcd 5069 (1992), aff'd, National Cable Television Association v FCC, No. 91-1649 (D.C. Cir. August 26, 1994) (NCTA v FCC); Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd 5781 (1992) (Second Report and Order), appeal pending sub nom., Mankato Citizens Telephone Company, No. 92-1404 (D.C. Cir. filed September 9, 1992).

2 See Second Report and Order, 7 FCC Rcd at 5787, para. 10 n.21.

3 Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779 (codified as amended at 47 U.S.C. § 533(b)(1) (1984) (1984 Cable Act)).

unreasonably low relative to the costs of providing such service. For instance, we set forth specific guidance for application of our pricing rules to ensure that interstate video dialtone rates cover video dialtone costs -- both the incremental costs of video dialtone and a reasonable allocation of shared plant costs and overheads. We also establish a data collection program to monitor the impact of video dialtone deployment on local rates as well as on separations results. Third, we modify our assertion of exclusive jurisdiction over all video dialtone services to recognize that states have jurisdiction over intrastate video dialtone services. This modification should provide a sound jurisdictional basis for the exercise of federal and state regulatory authority over video dialtone services. Finally, we issue a Third Further Notice of Proposed Rulemaking (Third Further Notice) seeking additional information and comment on various issues not adequately addressed in the record currently before us.

3. We conclude that video dialtone, as modified, will eliminate unnecessary regulatory barriers to competitive entry and to investment. In particular, by establishing a framework within which telephone companies may play an expanded role in the video marketplace, consistent with the 1984 Cable Act and the public interest, video dialtone will eliminate artificial barriers to competition and disincentives to investment by telephone companies in critical telecommunications facilities. Equally important, our video dialtone framework will eliminate artificial incentives to invest in facilities that are not needed to provide telecommunication services demanded by consumers. As a result, video dialtone will help achieve the three goals we have articulated throughout this proceeding: facilitating competition in the provision of video services; promoting efficient investment in the national telecommunications infrastructure; and fostering the availability to the American public of new and diverse sources of video programming.

4. These goals continue to guide our development of video dialtone policy, just as they did two years ago, when we adopted the Second Report and Order. Shortly after we adopted that order, Congress enacted the Cable Television Consumer Protection and Competition Act of 1992 (1992 Cable Act).<sup>4</sup> Congress there concluded that, in the absence of effective competition, regulation of cable service rates is necessary to protect consumer interests.<sup>5</sup> While

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4 Pub. L. No. 102-385, 106 Stat. 1460 (1992) (1992 Cable Act) (amending the Communications Act of 1934, as amended, 47 U.S.C. §§ 151 et seq. (Act or Communications Act)).

5 47 U.S.C. § 521(b)(4). For example, Congress found that without competition there was "undue market power for the cable operator, as compared to that of consumers and video programmers,"

the 1992 Cable Act thus substantially re-regulates the cable industry, that Act reflects Congress's preference for relying on competition, rather than regulation, to protect consumer interests. For example, the 1992 Cable Act specifically exempts from rate regulation cable systems that are subject to effective competition.<sup>6</sup> In addition, the legislative history of the Act stresses the need for policies that encourage the development of video services competition.<sup>7</sup> That Act also requires the Commission to report annually on the status of competition in the market for the delivery of video programming.<sup>8</sup>

5. In September 1994, the Commission issued its first annual report on competition in the delivery of video programming. While we found that alternative distribution media have made substantial strides over the last several years, the report concludes that "[t]he market for the distribution of multichannel video programming remains heavily concentrated at the local level, and for nearly all consumers cable television is the only provider of multichannel video programming." It also concludes that "[c]able systems continue to have substantial market power at the local distribution level."<sup>9</sup> Thus, the basic market structure that existed at the time of the Second Report and Order and that prompted passage of the 1992 Cable Act -- the dominance of cable systems in the multichannel distribution of video programming -- remains largely unchanged.

6. We also note that Congress recently considered, but did not enact, legislation that would have opened the door to new competition in a number of communications markets, including the local exchange and video services marketplaces. This proposed legislation included provisions to facilitate telephone companies' entry into the video programming marketplace. The absence of such legislation only heightens the need for a regulatory framework,

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and that "the cable television industry has become a dominant nationwide video medium." 47 U.S.C. § 521(a)(2-3).

6 47 U.S.C. § 543. See also 47 U.S.C. § 521(b)(2) ("It is the policy of the Congress in this Act to . . . rely on the marketplace, to the maximum extent feasible . . .").

7 See S. Rep. No. 92, 102d Cong., 2d Sess. 1, 18, reprinted in 1992 U.S. Code Cong. & Admin. News 1133, 1133, 1151; H.R. Rep. No. 628, 102d Cong., 2d Sess. 27, 30, 44 (1992).

8 47 U.S.C. § 548(g).

9 Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992, CS Docket No. 94-48, FCC 94-235 (released September 30, 1994), at 5.

consistent with existing law, that eliminates unnecessary barriers to LEC investment in video delivery systems. We believe that video dialtone, as modified herein, represents a framework that would be consistent with the goals of the legislation.

## II. BACKGROUND

7. In 1991, the Commission issued a Further Notice of Proposed Rulemaking, First Report and Order and Second Further Notice of Inquiry that considered the public interest benefits of allowing telephone companies to participate in the video marketplace through video dialtone.<sup>10</sup> The Further Notice tentatively concluded that a video dialtone policy would further the Commission's public interest goals of increased competition, improved infrastructure, and greater diversity in video programming.<sup>11</sup> The Further Notice described video dialtone and proposed a general regulatory framework to govern its implementation. As part of the regulatory framework, we proposed to amend our cross-ownership rules to permit telephone companies to provide video dialtone and related services. We tentatively concluded that these proposed amendments were fully consistent with the cross-ownership provisions of the 1984 Cable Act.<sup>12</sup>

8. In the First Report and Order, we issued interpretive rulings that, under the 1984 Cable Act, neither a LEC offering video dialtone nor its programmer-customers are required to obtain a cable television franchise.<sup>13</sup> We also concluded that interexchange carriers are not subject to the cross-ownership prohibition.<sup>14</sup> In the Second Further Notice of Inquiry, we asked whether we should recommend to Congress the repeal of the cross-ownership ban in light of the proposed video dialtone regulatory model. We also sought comment on what safeguards we should impose if LECs are permitted to provide video programming directly to subscribers. Finally, we asked for comment on whether other

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10 See generally First Report and Order; supra note 1.

11 See supra para. 3.

12 47 U.S.C. § 533(b). See also infra notes 72-73.

13 See First Report and Order, 7 FCC Rcd at 324-8, paras. 50-52. These rulings were upheld on judicial review. See NCTA v FCC, No. 91-1649 (D.C. Cir. August 26, 1994).

14 Id. at 322-3, para. 46.

statutory or regulatory changes would expand investment incentives for video dialtone.<sup>15</sup>

9. In the Second Report and Order, we modified our rules to permit LECs to provide video dialtone to the public, consistent with the statutory cross-ownership restrictions,<sup>16</sup> the regulatory framework we have developed for non-video enhanced services, and additional requirements designed to achieve the public interest goals enumerated above. Under the video dialtone framework we adopted, LECs are permitted to offer, on a nondiscriminatory basis, a basic common carrier video delivery platform that must accommodate multiple video programmers and expand as demand increases so as not to thwart realization of our public interest goals.<sup>17</sup> In addition, LECs may enter into certain non-ownership relationships with video programmers that have a certain nexus to the common carrier platform. For example, LECs may provide unregulated gateways to video programmers using the platform to enhance the ability of end users to select and receive video programming made available by those video programmers.<sup>18</sup> We concluded that existing safeguards designed to prevent improper

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15 First Report and Order, 7 FCC Rcd at 302, para. 2. The history of the Commission's rules regarding the ownership of cable television systems and provision of video programming by local telephone companies is set forth more fully in Telephone Company-Cable Television Cross-Ownership Rules, Section 63.54-63.58, Further Notice of Inquiry and Notice of Proposed Rulemaking, 3 FCC Rcd 5849, paras. 2-9 (1988). See also Telephone Company/Cable Television Cross-Ownership Restrictions (Notice of Inquiry), 2 FCC Rcd 5092 (1987).

16 47 U.S.C. § 533(b).

17 We defined "basic platform" as a common carriage transmission service, coupled with the means by which consumers can access any or all video program providers making use of the platform. Second Report and Order, 7 FCC Rcd at 5783, para. 2 n.3.

18 Second Report and Order, 7 FCC Rcd at 5784, para. 2 n.5. A gateway is a service that enables end users to select among a number of communications services, most commonly enhanced services. Id. Our rules define "enhanced services" as "services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 C.F.R. § 64.702(a) (1993). Enhanced services are not regulated under Title II of the Communications Act. Id.

cross-subsidies would apply to LEC provision of video dialtone service, and that it was not necessary to alter existing accounting, cost allocation and jurisdictional separations rules. We also permitted LECs to acquire an increased non-cognizable financial interest (up to 5%) in video programmers. We declined to adopt financial or other special incentives to promote video dialtone.

10. In addition, we recommended to Congress that it amend the 1984 Cable Act to permit LECs to provide, subject to appropriate safeguards, video programming directly to subscribers in their telephone service areas.<sup>19</sup> Finally, we proposed to amend the rural exemption to the cross-ownership rules to permit telephone companies to provide video programming directly to subscribers in areas of less than 10,000 persons.<sup>20</sup>

11. Twenty-three petitions for reconsideration of the Second Report and Order have been filed with the Commission. A variety of parties, including consumer groups, telephone companies, cable television interests, broadcasting interests, and state regulatory bodies, have asked the Commission to reconsider, clarify, or modify the Second Report and Order.<sup>21</sup>

12. In addition, CFA and NCTA filed the Joint Petition asking us to adopt video dialtone-specific cross-subsidy rules.<sup>22</sup> We

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19 Second Report and Order, 7 FCC Rcd at 5847, para. 135.

20 Id. at 5855, para. 150. This Order does not address the Commission's proposal to change the rural exemption.

21 Several parties filed petitions or other pleadings late. We accept these filings and treat them as informal comments in the interest of achieving a complete record.

22 In May 1994, a coalition of five consumer organizations filed two separate petitions asking us to: (1) ensure that video dialtone facilities are deployed in a nondiscriminatory manner and that services are made available universally, and (2) commence a rulemaking to modify the Section 214 application process to ensure equitable introduction of video dialtone and public involvement in the application process. The coalition consists of the Center for Media Education, Consumer Federation of America, Office of Communication of the United Church of Christ, National Association for the Advancement of Colored People, and the National Council of La Raza. See Petition for Relief from Unjust and Unreasonable Discrimination in the Deployment of Video Dialtone Facilities (filed May 23, 1994); Petition for Rulemaking to Adapt the Section 214 Process to the Construction of Video Dialtone Facilities (filed May 23, 1994). Comments on the petitions were due July 12, 1994.

address the petitions for reconsideration and the Joint Petition below.<sup>23</sup>

13. In the first section of our discussion, we address telephone company provision of video dialtone. This section discusses the video dialtone platform requirements, specifically, the capacity and expandability requirements and restrictions prohibiting LECs from acquiring cable systems in their telephone service areas for the provision of video dialtone. We also discuss telephone company activities permissible under video dialtone, i.e., the ownership affiliation standards and rules governing non-ownership relationships between LECs and video programmers, as well as the definition of video programming. The last portion of the first section addresses the extent of our jurisdiction over video dialtone services. The second section addresses our regulatory framework and safeguards for the provision of video dialtone service. Specifically, we examine our authority to require a Section 214 application before a LEC constructs and operates a video dialtone facility, as well as requests for streamlining or eliminating the Section 214 requirement for video dialtone, and for delaying consideration of pending Section 214 applications for video dialtone. We also address cross-subsidy and pricing issues, our two-level regulatory framework for video dialtone, and safeguards, including joint marketing and Customer Proprietary Network Information (CPNI) issues. In the third section we discuss the issue of preferential access to the video dialtone platform for certain classes of video programmers and whether to establish special incentives to accelerate LEC deployment of broadband facilities. The last section of our discussion in this Order addresses our recommendation to Congress that it amend the 1984 Cable Act to permit LECs to provide video programming directly to subscribers in their telephone service areas, subject to appropriate safeguards.

14. We also initiate a Third Further Notice seeking additional information and comment on various issues.

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Replies were due July 27, 1994. The issues raised in the petitions deserve serious consideration, but we have not yet had an opportunity to review fully all of the information and arguments submitted in response to them. We are committed to careful review of the record and plan to act on these matters promptly.

23 A list of parties filing petitions for reconsideration or pleadings in response to a petition is appended as Appendix A. A list of parties filing pleadings regarding the Joint Petition is set forth in Appendix B. Pleadings filed in response to the Joint Petition are identified as such herein. Pleadings in response to a reconsideration petition are referred to simply as comments or replies.

Specifically, we seek information and comment on: (1) mechanisms for addressing the apparent short-term constraints on the expandability of analog channel capacity; (2) modifications to our prohibition on acquisition of cable facilities and a corresponding modification to our non-ownership affiliation rules; (3) proposals that we require or permit LECs to provide preferential video dialtone access or rates to certain classes of video programmers; and (4) possible changes to our rules governing pole attachments and conduit rights.

15. The video dialtone framework that we describe in this Order applies the 1984 Cable Act cross-ownership ban. We note that four courts have ruled the 1984 Cable Act ban on telephone company provision of video programming unconstitutional.<sup>24</sup> The record in this proceeding does not address, and we therefore here do not decide, what framework should apply to LECs that provide video programming directly to subscribers.

### III. SUMMARY

16. This Order clarifies or modifies the Second Report and Order in several respects. These modifications are consistent with our intent to eliminate artificial regulatory barriers to competitive entry and to efficient investment, thereby facilitating competition in video delivery services, investment in infrastructure, and greater diversity in video programming. First, we elaborate on our requirement that LECs expand the capacity of their video dialtone platform as demand increases by clarifying that LECs must expand to the extent technically feasible and economically reasonable. To monitor LEC capacity and ensure that LECs expand in accordance with this standard, we require LECs operating video dialtone systems to provide us with notice of anticipated or actual capacity shortfalls and of plans for addressing them.

17. Second, we hold that our prohibition on the acquisition by LECs of cable facilities in their service areas for the provision of video dialtone does not preclude LECs from leasing an in-region cable operator's drop wires, provided that any such lease is limited in scope and duration and does not permit LECs to impede the development of additional competition in video delivery services.

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24 See The Chesapeake and Potomac Telephone Co. of Virginia v. United States, 830 F.Supp. 909 (E.D. Virginia 1993), appeal pending; US West, Inc. v. United States, 855 F.Supp. 1184 (W.D. Wash. 1994), appeal pending; BellSouth Corp. v. United States, No. CV 93-B-2661-S (N.D. Ala. Sept. 23, 1994); Ameritech Corp. v. United States, Nos. 93-C-6642 and 94-C-4089 (N.D. Ill. Oct. 27, 1994).

18. Third, we elaborate on our ownership affiliation rules by clarifying that they restrict LEC ownership interests in video programmers and not video programming. We define video programmers as entities that provide video programming directly to subscribers. Any entity shall be deemed to "provide" video programming if it determines how video programming is presented for sale to subscribers, including making decisions concerning the bundling or "tiering" of the video programming or the price, terms, or conditions on which video programming is offered to subscribers.

19. Fourth, we modify our non-ownership affiliation rules by: (1) permitting LECs to provide enhanced and other nonregulated services in connection with any video programming offered in an area substantially served by a video dialtone platform; (2) permitting LECs to enter into certain other types of non-ownership relationships with video programmers who are not franchised cable operators in the LEC service area, regardless of whether the LEC has built a video dialtone platform in the area served by those programmers; (3) prohibiting LECs from exceeding the carrier-user relationship in their telephone service area with cable operators, except to provide enhanced or other nonregulated services, as permitted above, or to lease drop wires; and (4) generally prohibiting LECs from entering into non-ownership relationships that would permit any video programmer to participate in operating the basic video dialtone platform.

20. Fifth, we modify our jurisdictional determination that we have exclusive jurisdiction over all video dialtone services. We hold instead that we have exclusive jurisdiction only over video communications that have been transmitted over radio waves or across state lines.

21. Sixth, we deny requests to eliminate, streamline, or delay the Section 214 process, but hold that LECs may file generic Section 214 applications for those aspects of proposed video dialtone platforms that do not require case-by-case consideration.

22. Seventh, we grant the CFA and NCTA Joint Petition for rulemaking to the extent it requests that we begin a rulemaking to establish a price cap basket for video dialtone services. We deny the petition for rulemaking to the extent it asks that we issue a Notice of Proposed Rulemaking proposing service-specific cost allocation rules for video dialtone service and establish immediately a Federal-State Joint Board to address jurisdictional separations issues. We require carriers to: (1) establish subsidiary accounting records to capture video dialtone revenues, investments, and expenses; (2) file revisions to their Cost Allocation Manuals (CAMs) for their provision of nonregulated video dialtone services; and (3) obtain any necessary waivers of our Part 69 rules prior to tariffing video dialtone service offerings. We establish specific guidance regarding the application of the price caps new services test to video dialtone tariffs. In addition, we

direct the Common Carrier Bureau to develop a data collection program to monitor the effects of video dialtone on separations results and on local telephone rates. We also announce our intention to open an inquiry into the impact of the introduction of new network technologies on the jurisdictional separations process.

23. Eighth, we add video dialtone service to the basic service categories for which we require that LECs report installation and maintenance activities. In addition, while we maintain existing CPNI rules for video dialtone at this time, we direct the Bell Operating Companies (BOCs) and GTE to provide additional information about the types of CPNI to which they will have access as providers of video dialtone service so that we may further assess whether these rules properly balance the various interests at stake. Finally, in light of the detailed examination we give in this Order to our video dialtone policies and rules, and our continuing work on major video dialtone issues through the data request and Third Further Notice, we cancel next year's planned reexamination of video dialtone. We otherwise affirm our holdings in the Second Report and Order.

24. Our Third Further Notice seeks additional information and comment in four areas. First, we seek comment on proposals for addressing the apparent technical and economic constraints on the provision and expansion of analog channel capacity. We seek comment, in particular, on two possible proposals: (i) a proposal advanced by GTE in its Section 214 application to make extensive use of digital capacity; and (ii) "channel sharing" mechanisms, through which video programmers would be able to share analog channels, thereby permitting a more efficient use of analog channel capacity. Second, we seek comment on criteria for evaluating the viability of additional wire-based video competition in particular markets. We propose to use these criteria to modify our ban on the acquisition by telephone companies of cable facilities in their telephone service areas for use in the provision of video dialtone. We also propose to permit LECs and cable operators jointly to construct a video dialtone platform in any area in which we lift the acquisition prohibition. Third, we seek information and comment on whether we should require or permit LECs to provide preferential access or discounted rates to commercial broadcasters and/or to certain types of not-for-profit programmers. Fourth, we request comment on whether we should adopt additional rules with respect to pole attachments and conduit rights.

#### IV. DISCUSSION

##### A. Telephone Company Provision of Video Dialtone

###### 1. Requirements for a Video Dialtone Platform

###### a. Sufficient Capacity to Serve Multiple Service Providers

##### Background

25. In the Second Report and Order, the Commission required that video dialtone systems be offered on a nondiscriminatory common carrier basis<sup>25</sup> and contain sufficient capacity to serve multiple video programmers.<sup>26</sup> The Commission also determined that the common carrier platform must have the ability to "expand as demand increases so as not to become a bottleneck that will thwart realization of our public interest goals."<sup>27</sup> The Commission directed telephone companies seeking to provide video dialtone to describe in their Section 214 applications how their proposed construction and operation of the basic platform will meet this requirement.

##### Pleadings

26. Southwestern Bell Telephone (SWBT) asks us to eliminate the requirement that LECs offer capacity to serve multiple video programmers and expand that capacity as demand increases. It contends that this requirement places LECs at an unfair competitive disadvantage vis-a-vis cable operators, who are the incumbent video service providers and are subject to no such requirements. It argues, further, that insofar as many of the technologies cited by the Commission as potential video dialtone technologies do not offer unlimited capacity, the Commission's capacity requirements are inconsistent with its avowed intent to avoid dictating video dialtone technology.<sup>28</sup> It asserts that the technology necessary to meet these requirements does not currently exist and that, therefore, the requirements are likely to delay, if not eliminate, the ability of LECs to provide video dialtone.<sup>29</sup>

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25 Second Report and Order, 7 FCC Rcd at 5783, para. 2.

26 Id. at 5797, para. 29.

27 Id. at 5797-98, para. 30.

28 SWBT Petition at 9.

29 Id. at 8-10; SWBT Reply Comments at 3-4.

27. SWBT argues also that the Commission's capacity requirements ignore economic realities.<sup>30</sup> SWBT maintains that video programmers face significant capital and operating costs and will not be able to attract a sufficient number of subscribers necessary for survival unless they can each offer a full range of programming, like the competing cable operator. SWBT argues that the vast majority of markets will be unable to support more than one programmer on the video dialtone network. SWBT asserts that it should not be required to expend substantial sums of money to provide capacity for programmers who, according to its market research, are not likely to be viable. SWBT also argues that it should be permitted to allocate most of its analog channel capacity to a single video programmer, who would then be able to compete viably with the incumbent cable operator. It suggests that the Commission's capacity goals could be met if this video programmer made these analog channels available on a resale basis to other programmers, who would use digital channels for their other services.<sup>31</sup>

28. In an ex parte letter dated July 7, 1994, PacTel, BellSouth, and GTE join SWBT in arguing that a viable competitive offering must include an "anchor programmer," which would offer a service package comparable to that offered by cable operators.<sup>32</sup> They argue that LECs should be given flexibility in allocating channels, including the ability to allocate all analog channels to one anchor programmer. They argue that such an allocation would help smaller programmers, who could use the anchor programmer's product as a foundation with which to associate their own offerings.

29. The Office of Communications of the United Church of Christ (OC\UCC) argues that video dialtone should be more than just "channel service" and that the Commission's capacity and expansion requirements are necessary to foster diversity of viewpoints.<sup>33</sup>

### Discussion

30. We now affirm our requirement that telephone companies wishing to offer video dialtone service must make available a basic common carrier platform offering sufficient capacity to serve

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30 See SWBT ex parte letter, May 20, 1994; SWBT ex parte letter, June 1, 1994.

31 See SWBT ex parte letter, May 20, 1994.

32 See PacTel, GTE, BellSouth, and SWBT ex parte letter, July 7, 1994.

33 OC\UCC Petition at 1-2.

multiple video programmers. We also affirm our expandability requirements, subject to the modification discussed below.

31. In adopting a common carrier regulatory model for video dialtone, we found that this model was critical to our determination that video dialtone is in the public interest.<sup>34</sup> We stated that the common carrier platform will serve as the foundation through which multiple video programmers can provide services to consumers, and is thus critical to achieving increased competition in the delivery of video services and greater diversity of video programming.<sup>35</sup> We also noted that the basic common carrier platform will provide an important check against unreasonably discriminatory treatment of video programmers by telephone companies providing video dialtone service.

32. No one has persuaded us that these findings should be revised. On the contrary, we continue to believe that maintaining common carrier obligations on the basic video dialtone platform is fundamental to achieving our public interest goals. This requirement will enable multiple video programmers to obtain access on nondiscriminatory terms to LEC video delivery capabilities, thereby fostering new and diverse sources of video programming and generating competition in the provision of such programming to end users.<sup>36</sup> Such competition will be generated both among users of the video dialtone platform and among such users and video programmers that use other systems, such as cable systems, to distribute their products to end users in the same geographic area.

33. We also affirm our requirement that video dialtone common carrier platforms offer sufficient capacity to serve multiple video programmers. Without this requirement, video dialtone would not be as effective in achieving our goal of fostering a diversity of information sources to the public. This goal was and remains one of the key purposes of our video dialtone policy.<sup>37</sup> Indeed, without this requirement, it is not clear that video dialtone service would differ materially from channel service, which telephone companies

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34 Second Report and Order, 7 FCC Rcd at 5797, para. 29.

35 Id.

36 See NCTA v. FCC, No. 91-1649, slip op. at 18 (D.C. Cir. Aug. 26, 1994) ("[V]ideo dialtone is a common carrier service, the essence of which is an obligation to provide service indifferently to all comers -- here, to provide service to all would-be video programmers").

37 Second Report and Order, 7 FCC Rcd at 5783-84, para. 1-2; see supra para. 3.

were able to provide to cable operators even before we adopted the video dialtone framework.

34. We are not convinced by SWBT's arguments that our capacity requirement is inconsistent with our desire to remain technology-neutral with respect to video dialtone deployment, or that the technology necessary for LECs to meet this requirement is not yet available. As an initial matter, our stated preference for remaining technology-neutral applies to technologies that are consistent with our basic video dialtone requirements; we are not technology-neutral with respect to technologies that cannot meet those requirements. Second, contrary to SWBT's assertion, LECs have numerous options available to them for meeting the capacity requirement. Indeed, we have already approved six video dialtone applications, involving varying technologies and architectures.

35. We also reject requests that LECs be permitted to allocate all or substantially all analog capacity to a single "anchor programmer." These requests appear to be premised on the assumption that only analog capacity allows a viable alternative to cable service in the short-term. To grant these requests would thus be inconsistent with the common carrier model for video dialtone and our requirement that LECs offer sufficient capacity to accommodate multiple video programmers.<sup>38</sup>

36. Finally, we affirm our expandability requirement, subject to the modification discussed below. This requirement, we believe, compounds the benefits of video dialtone by ensuring greater diversity in the sources of video programming and fostering infrastructure development. Absent this requirement, the initial programmer-customers of video dialtone might exhaust all video dialtone capacity, thereby preventing new programmers from using these systems. In addition, the expandability of video dialtone systems is a critical factor in reducing the ability of LECs to discriminate in their provision of video dialtone service. Specifically, it precludes LECs from limiting capacity or avoiding further investment in their video dialtone systems in order to insulate certain video programmers from competition.

37. We are not persuaded by SWBT's argument that it is unfair to apply capacity and expandability requirements to LECs but not

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38 Some LECs, such as Bell Atlantic and NYNEX, apparently do not share the assumption that only analog channels can viably compete with cable programming in the short-term. These LECs have proposed substantially all-digital systems. See, e.g., New Jersey Bell Telephone Company, 9 FCC Rcd 3677 (1994), recon. pending, petitions for stay pending (New Jersey Bell); New England Telephone and Telegraph Company (NYNEX), File No. W-P-C-6982 (filed July 8, 1994).

cable operators. Cable service is subject to a different statutory and regulatory regime than video dialtone service. The regime governing cable service imposes obligations that do not apply to video dialtone, including franchise requirements and other obligations imposed by the 1984 and 1992 Cable Acts.<sup>39</sup> SWBT has not shown that the burdens imposed by our common carrier framework would prevent LECs from competing in the video marketplace.

38. While we affirm our capacity and expandability requirements, we take this opportunity to elaborate on the scope of the expandability obligation. As critical as this obligation is to our video dialtone construct, it would not be reasonable to require LECs to expand to meet all demand, regardless of technical and economic considerations. Indeed, such a requirement might well discourage LECs from constructing and operating video dialtone systems because of the risk of excessive idle investment. We therefore clarify that, under our video dialtone requirements, LECs are required to expand whenever, and to the extent that, expansion is technically feasible and economically reasonable. A LEC may not refuse to expand simply because it does not wish to permit video programmers to offer certain types of video programming on its video dialtone system. We will address claims by LECs that expansion is not technically feasible and economically reasonable on a case-by-case basis in light of all relevant circumstances. In this review process, we will look to all relevant information and data, including the capacity offered on other video dialtone systems, data relating to demand for video delivery in the LEC's region or in comparable regions, and technical data. To monitor LEC progress in expanding capacity and to ensure that LECs expand in accordance with the standards set forth herein, we require LECs to notify the Chief of the Common Carrier Bureau of any anticipated or existing capacity shortfall and of plans for addressing such shortfall. Such notice must be provided within thirty days after the LEC becomes aware of an anticipated capacity shortfall or within five days after denying capacity to a video programmer, whichever occurs first. To the extent a LEC concludes that expansion is not technically feasible or economically reasonable at that time, the LEC must explain in detail the basis for its determination and indicate when it anticipates expansion would be technically feasible and economically reasonable.

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39 See NCTA v. FCC, No. 91-1649 (D.C. Cir. Aug. 26, 1994). As noted, the video dialtone framework set out in this Order applies to LECs that do not provide video programming directly to subscribers in their telephone service area. Therefore, we do not address the extent to which LECs providing video programming directly to subscribers in their telephone service area may need a franchise.

39. We recognize that, at least in the short term, it may not be feasible for LECs to meet all demand for capacity due to technical limits on the expandability of analog capacity and the costs associated with using digital capacity. On the other hand, to the extent digital transmission can supplement analog transmission, the capacity of video dialtone systems increases significantly. In the Third Further Notice, we seek comment on a proposal for expediting the viability of digital capacity. We also seek comment on proposals that would allow more efficient use of analog capacity.<sup>40</sup>

#### **b. Acquisition of Cable Facilities**

##### **Background**

40. In the Second Report and Order, the Commission prohibited LECs from purchasing cable facilities in their service area for the provision of video dialtone.<sup>41</sup> The Commission found that permitting such acquisitions would diminish the incentives that cable and telephone companies have to compete directly. The Commission also found that permitting such acquisitions could create incentives for cable companies to evade local franchising requirements. At the same time, however, the Commission retained its rules allowing LECs to acquire cable facilities in their telephone service areas in order to lease those facilities back to the local cable operator<sup>42</sup> for use in providing cable service pursuant to Title VI of the Communications Act.

##### **Pleadings**

41. Several LECs, NCTA, and the New England Cable Television Association (NECTA) seek reconsideration of the prohibition on the acquisition of cable facilities for the purpose of offering video dialtone.<sup>43</sup> They argue that LECs should be able to purchase cable facilities, not only for the purpose of providing leasebacks, but

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40 See Third Further Notice, infra, paras. 268-275.

41 Second Report and Order, 7 FCC Rcd at 5837-38, paras. 109-111.

42 Id. at 5838. See 47 C.F.R. § 63.54(d)(3).

43 See Ameritech Petition at 11-15; Bell Atlantic Petition at 6-7; BellSouth Petition at 8-9; NYNEX Petition at 7-8; PacTel Petition at 4-7; SWBT Petition at 5-6; US West Petition at 11-13; NCTA Petition at 16-18; GTE Petition at 3 n.4. See also NCTA Reply Comments at 7-8; NECTA Comments at 5-6; USTA Comments at 14-15; Ameritech Reply Comments at 3; SWBT Comments at 1-2; Bell Atlantic Reply Comments at 4-5 & n.16; PacTel Reply Comments at 2-5; and GTE Reply Comments at 9 n.27.

also for use in providing video dialtone. Many of these petitioners contend that, given the common carrier nature of video dialtone, the Commission's goals could be more economically and efficiently achieved if the prohibition did not exist.<sup>44</sup> They argue that there can be meaningful competition among video programmers, diversity of programming, and infrastructure improvement over a single, common carrier wire.<sup>45</sup> Other commenters assert that the ban on acquisitions will force consumers and ratepayers to bear the cost of building an unnecessary and redundant system.<sup>46</sup> In addition, they argue, building duplicate facilities will slow the development of video dialtone and the broadband network.<sup>47</sup> Several petitioners argue that the prohibition could deter the widespread deployment of video dialtone by eliminating markets unable to support more than one system.<sup>48</sup> Some also contend that the added costs of constructing redundant systems contradict the Commission's stated goal of making video dialtone available at a reasonable cost.<sup>49</sup> Finally, NYNEX asserts that there is no valid statutory basis for the ban.<sup>50</sup>

42. NCTA and NECTA state that LECs have a competitive advantage over cable operators because LECs are not subject to

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44 See Ameritech Petition at 11-15; Bell Atlantic Petition at 6-7; BellSouth Petition at 8-9; PacTel Petition at 4-7; NYNEX Petition at 8; US West Petition at 11-13; and SWBT Petition at 5-6. See also NYNEX Reply Comments at 4-6; Ameritech Reply Comments at 3; Bell Atlantic Reply Comments at 4-5; Bell Atlantic Comments at 4; PacTel Reply Comments at 1-5; SNET Comments at 2-5; and USTA Comments at 14-15.

45 See PacTel Petition at 4-7; Ameritech Petition at 13; PacTel Comments at 1-5; PacTel Reply Comments at 2-5; SNET Comments at 2-5; USTA Comments at 14-15.

46 NCTA Petition at 16-18; Bell Atlantic Petition at 6-7; SWBT Petition at 34; PacTel Petition at 4-5; Ameritech Petition at 14. See also SWBT Petition at 5-6.

47 See NCTA Petition at 16-18; Bell Atlantic Petition at 6-7. See also Bell Atlantic Comments at 4; Bell Atlantic Reply Comments at 5; PacTel Petition at 5-7; PacTel Comments at 1-5. But see CFA/CME Comments at 9-11.

48 BellSouth Petition at 8-9; Ameritech Petition at 13.

49 Ameritech Petition at 13; SWBT Petition at 3-5.

50 NYNEX Petition at 8.

local franchise requirements.<sup>51</sup> As a result, they claim, cable companies must have the ability to avoid losses by selling their cable systems to local telephone companies.<sup>52</sup>

43. Ameritech and US West maintain that the restriction is at odds with the Commission's decision to permit LECs to acquire cable facilities and lease them back to a local franchise operator. They argue that in the case of a leaseback, the cable operator maintains its monopoly over video services, whereas if the telephone company uses the cable company's facilities for video dialtone, the market is opened to a multitude of video program providers. Southern New England Telephone Company (SNET) maintains that the restriction on acquisitions conflicts with the Commission's intent to remain neutral with respect to video dialtone technology.<sup>53</sup>

44. A few petitioners ask us to modify or clarify the prohibition in the event that we do not eliminate it altogether.<sup>54</sup> Bell Atlantic asks us to clarify that the prohibition applies only to the purchase of entire cable systems, and that LECs may acquire or use particular cable facilities, such as wires from the "curb to the home," also referred to as "drop wires," or customer premises wiring, when it is more economical than building duplicative facilities.<sup>55</sup> BellSouth asks us to clarify that the restriction does not preclude LECs from acquiring either excess capacity from an existing cable facility or an entire facility in markets where there already are two cable operators.<sup>56</sup> Likewise, GTE asserts that the purchase of an existing cable facility in a nonexclusive franchise environment does not discourage diversity of program sources or permit evasion of franchise requirements. GTE asks us to reconsider the blanket ban on acquisitions and to review individual proposals on a case-by-case basis through the section 214 process.<sup>57</sup>

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51 NCTA Petition at 16-18; NCTA Reply Comments at 7-8; NECTA Comments at 5-6.

52 NCTA Petition at 16- 18; NCTA Reply Comments at 8.

53 SNET Comments at 2-5.

54 Bell Atlantic Petition at 6-7; BellSouth Petition at 8-9; GTE Petition at 3 n.4.

55 Bell Atlantic Petition at 6-7; Bell Atlantic Reply Comments at 5 n.16.

56 BellSouth Petition at 9.

57 GTE Petition at 3 n.4.

45. The Consumer Federation of America and Center for Media Education (CFA/CME), National Association of Telecommunications Officers and Advisors, the National League of Cities, the U.S. Conference of Mayors, and the National Association of Counties (Coalition of Local Governments or CLG), National Association of Broadcasters (NAB) and Action for Children's Television and Henry Geller (ACT) support retention of the acquisition ban.<sup>58</sup> They argue that the ban is essential to prevent LECs from merely substituting one video services monopoly for another. CFA/CME argue that facilities-based competition is needed if consumers are to have access to diverse services and programming at reasonable prices. They assert, further, that facilities-based competition could eliminate the need for cable rate regulation. NAB and ACT add that LEC purchases of cable systems could not only eliminate competition in video services, but a viable source of competition in residential local telephone services.<sup>59</sup> CLG argues that the benefits of the local franchise system would be lost if cable companies are permitted to sell their facilities to a LEC.<sup>60</sup>

46. NAB argues that, while it is possible that some markets may be unable to support both a cable and a video dialtone system, no LEC has shown that the complete elimination of the acquisition ban is necessary to spur video dialtone implementation nationwide. It argues that any exceptions to the ban should thus be established through the waiver process. Similarly, it opposes BellSouth's proposal that acquisitions of overbuilder facilities be authorized, claiming that these situations as well are best addressed through waiver applications. It also opposes BellSouth's request that LECs be permitted to purchase excess capacity from cable operators. It argues that, since multiple cable companies generally provide service within a local exchange carrier's service area, and since not all of these operators would necessarily have excess capacity, a LEC relying on excess capacity would not likely be able to provide ubiquitous service. Additionally, citing provisions of the

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58 CFA/CME Comments at 9-11; CLG Comments at 5-6; NAB Comments at 13-15; ACT Petition at 13 n.11.

59 NAB Comments at 14-15; ACT Petition at 13 n.11. NAB argues that while the Commission's Expanded Interconnection proceeding may foster local exchange competition for large users, the cable industry "represents the only realistic possibility for competition to telcos in residential wireline services." NAB Comments at 14-15.

60 CLG Comments at 5-6.

Communications Act, NAB challenges NYNEX's assertion that the ban has no statutory basis.<sup>61</sup>

47. NAB also responds to NCTA's assertion that the prohibition is unfair to cable companies. NAB argues that new compression technology, coupled with the use of fiber optics in system upgrades, will enable even the most archaic cable systems to expand capacity significantly and thereby compete viably with LEC video dialtone systems. It argues that monopolist cable operators should not be provided a "golden parachute" that enables them to escape competition.

### Discussion

48. We now substantially affirm our decision in the Second Report and Order to prohibit telephone companies from acquiring cable facilities in their telephone service areas for the provision of video dialtone.<sup>62</sup> We believe that generally retaining the ban will benefit the public by promoting greater competition in the delivery of video services, increasing the diversity of video programming, and advancing the national communications infrastructure. At the same time, however, we recognize that the ban may effectively preclude the deployment of video dialtone systems in markets that cannot support an additional wired video delivery system and could in those markets impede our goal of eliminating regulatory barriers to investment. In the Third Further Notice below, we seek information and comment that would permit us to develop criteria for identifying those markets.<sup>63</sup> We also propose to amend our rules so that these criteria serve as the basis for either an automatic exception to the ban or a presumption that the ban should not apply.

49. In general, opponents of the ban assert that it is an inefficient and counterproductive means of implementing video dialtone, and one that is likely to deter widespread deployment of video dialtone.<sup>64</sup> Contrary to these assertions, we believe that

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61 NAB Comments at 13-14, citing §§ 601(6) and 628 of the Act (enacted as part of the 1992 Cable Act). See also CFA/CME Comments at 11.

62 Second Report and Order, 7 FCC Rcd at 5837-38, paras. 109-111.

63 See Third Further Notice, infra paras. 276-79.

64 See Ameritech Petition at 11-15; Bell Atlantic Petition at 6-7; BellSouth Petition at 8-9; NYNEX Petition at 7-8; PacTel Petition at 4-7; SWBT Petition at 5-6; US West Petition at 11-13; NCTA Petition at 16-18; GTE Petition at 3 n.4. See also NCTA Reply Comments at 7-8; NECTA Comments at 5-6; USTA Comments at 14-15;

retaining the ban in areas where facilities-based competition is viable will spur the development of competitive wire-based video delivery systems, thereby offering significant benefits to consumers. First, the added competition will likely provide a check on both cable and video dialtone rates. LECs that charge too much for video dialtone delivery services will face the risk that video programmers will forego video dialtone service and rely on cable systems for distribution of their product. To the extent that competition can provide a check on video dialtone rates, video programmers will be able to lower their rates to consumers. This, in turn, would constrain cable rates.<sup>65</sup> Second, competition between cable operators and LECs would give both incentives to invest in infrastructure and develop new and innovative services to increase the attractiveness of their products to consumers. Third, the availability of additional distribution systems would offer increased channel capacity, thereby fostering greater diversity of programming options for consumers. Retaining the ban could also facilitate the development of competitive local telephone networks by cable operators.<sup>66</sup>

50. By contrast, if we eliminate the ban, LECs might seek to acquire cable systems in their service areas to eliminate competition in the provision of video delivery services. They might also have incentives to acquire cable facilities to eliminate a likely competitor in the provision of local telephone services. At the same time, elimination of the ban would unacceptably increase cable operators' incentives to move their video programming to a LEC's video dialtone system, rather than make the changes necessary to respond effectively to competition.<sup>67</sup> We

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Ameritech Reply Comments at 3; SWBT Reply Comments and Comments at 1-2; Bell Atlantic Reply Comments at 4-5 & n.16; PacTel Reply Comments at 2-5 and GTE Reply Comments at 9 n.27.

65 In fact, we anticipate that, as LEC video dialtone services are deployed, cable operators may be able to demonstrate that they are subject to "effective competition" and thus not subject to rate regulation by the Commission, state, or franchising authority. See Section 623(a)(2) of the 1992 Cable Act, 47 U.S.C. § 543(a)(2).

66 Just as we believe that full and fair competition in the provision of video services would serve the public interest, we believe that heightened competition in local telephone services would be beneficial, and we strongly support removal of restrictions that limit such competition.

67 Consistent with the common carrier nature of the basic video dialtone platforms, we do not preclude in-region cable operators from becoming customers on these platforms. However, as a result of the ban, it may not be economically feasible for them to do so.

therefore disagree with parties who argue that eliminating the ban would allow market forces to dictate the deployment of video dialtone technology.

51. We also disagree with those who argue that our ban is inconsistent with our policy of permitting LECs to acquire cable facilities for leasing to the local franchised cable operator. These parties ignore that, in the case of leaseback arrangements (i.e., channel service), the cable operator continues to provide cable television service and remains subject to franchise requirements and the other provisions of Title VI of the Act. Only by moving its video programming to the video dialtone platform can a cable operator avoid such requirements, and as noted, our ban reduces the incentives of cable operators to do so. In addition, we disagree with NYNEX's assertion that we lack authority to implement the ban. We believe that the ban falls well within our authority under Title II of the Act to ensure that common carrier services are provided in a manner that is consistent with the public interest.<sup>68</sup>

52. We recognize that prohibiting telephone company acquisitions of in-region cable systems may affect the cost of deploying video dialtone systems. We believe, however, that, at least where facilities-based competition is viable, the benefits of the ban outweigh the costs. We also recognize that video dialtone, by itself, could foster infrastructure development, competition among video programmers, and diversity of video programming. It is, in part, for this reason that we propose to modify the ban in markets that cannot sustain additional wire-based competition. In other markets, however, competing video distribution systems offer the prospect of even greater benefits than a single video dialtone system. Finally, we understand that our ban could prevent failing cable companies from selling their facilities to the video dialtone provider. We are not persuaded, however, that our policy will cause undue hardship to cable companies. First, we have no reason

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In particular, unless a cable operator using video dialtone could sell its facilities to a third party, that operator would have to recover both video dialtone charges and the cost of its embedded investment in its cable system from end user revenues, and still compete with other video programmers, including other programmer-customers of the video dialtone provider. As discussed below, the restrictions we place on non-ownership relationships between LECs and cable operators in the LECs' telephone service area should further reduce the incentives of cable operators to move their programming to a video dialtone system. See infra para. 95.

68 See 47 U.S.C. §§ 201-205, 214. See also Title VI of the Act, including §§ 601(6), 623, and 628, which reflect Congress's goal of promoting competition in the multichannel video programming market.